

Message Text

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TO AMEMBASSY MOSCOW

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SUBJECT: NEW USSR TAX DECREE

REF: (A) MOSCOW 13635, (B) MOSCOW 13227 (C) STATE 148122

1. APPRECIATE REPORT ON JUNE 12 DISCUSSIONS.
2. RE AEROFLOT, THE PROFITS OF AEROFLOT AND THE SALARIES OF CREW MEMBERS ARE EXEMPT FROM U.S. TAX UNDER THE TREATY. EMPLOYEES OF AEROFLOT STATIONED IN THE UNITED STATES ARE

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NOT EXEMPT FROM U.S. TAX ON THEIR SALARIES UNDER THE TREATY. NOR ARE PAN AM EMPLOYEES IN USSR EXEMPT FROM USSR TAX UNDER THE TREATY. IN THE LATTER CASE, THE USSR TAX WOULD BE CREDITED AGAINST (DEDUCTED FROM) THE US TAX ON THAT INCOME. (USSR HAS NO COMPARABLE TAX CREDIT IN ITS LAW, SO AEROFLOT EMPLOYEES COULD BE SUBJECT TO DOUBLE TAXATION.)

3. IN TAXING AEROFLOT EMPLOYEES THE TREATY FOLLOWS THE TRADITIONAL RULE IN SUCH CASES, THAT INDIVIDUALS LIVING

IN A COUNTRY HAVE A TAX OBLIGATION TO THAT COUNTRY. TREATIES MAKE EXCEPTIONS FOR STAYS OF LESS THAN 6 MONTHS AND IN SPECIAL CASES (TEACHERS, TRAINEES, ETC.) FOR STAYS OF 1-2 YEARS. GOVERNMENT EMPLOYEES ARE EXEMPT INDEFINITELY, BUT ONLY IF THEY ARE PERFORMING GOVERNMENTAL FUNCTIONS, NOT IF THE AGENCY THEY WORK FOR CARRIES ON COMMERCIAL ACTIVITY. AEROFLOT EMPLOYEES ARE GOVERNMENT EMPLOYEES, BUT ENGAGED IN A COMMERCIAL UNDERTAKING. THEIR STATUS WAS SPECIFICALLY DISCUSSED IN THE TREATY NEGOTIATIONS AND USSR NEGOTIATORS AGREED IN UNEQUIVOCAL TERMS THAT THEIR SALARIES ARE TAXABLE IN US. IN ADDITION, THEY ARE SPECIFICALLY MENTIONED AS NOT COMING UNDER THE TREATY EXEMPTION OF GOVERNMENTAL SERVICES IN THE TECHNICAL MEMORANDUM EXPLAINING THE TREATY, WHICH WAS SENT TO USSR OFFICIALS IN MOSCOW PRIOR TO RATIFICATION OF THE TREATY.

4. IN MOST COUNTRIES, THE AIRLINE IS A GOVERNMENT ENTERPRISE; BUT IN NO CASE DOES A US TREATY EXEMPT AIRLINE EMPLOYEES. WE ARE PREPARED TO CONSIDER SPECIAL RULES IN THE CASE OF THE USSR, BUT COULD ONLY CHANGE THE PRESENT TREATY RULE BY AN AMENDMENT TO THE TREATY SUBJECT TO SENATE APPROVAL. SOVIET EMBASSY REPRESENTATIVES IN WASHINGTON HAVE RAISED ISSUE WITH TREASURY AND LIMITED OFFICIAL USE

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STATE. AT A MEETING ON JUNE 9 IT WAS DECIDED THAT BOTH SIDES WILL REVIEW TREATY TO SEE IF THERE ARE OTHER PROVISIONS WHICH SHOULD BE MODIFIED. CHANCES OF SENATE APPROVAL OF AN AMENDMENT SOLELY FOR PURPOSE OF EXEMPTING AEROFLOT AND PAN AM EMPLOYEES FROM TAX, RECIPROCALLY, SEEM SLIGHT.

5. IT IS ACCURATE THAT SINCE TREATY EXEMPTION FOR CORRESPONDENTS IS LIMITED TO TWO YEARS PER PERSON, SOME CORRESPONDENTS WILL BECOME TAXABLE IN 1978. THE EXEMPTION FOR CORRESPONDENTS IS UNIQUE IN US TAX TREATIES AND CAUSED CONCERN WHEN THE TREATY WAS UNDER SENATE CONSIDERATION. IT, TOO, COULD BE EXTENDED IN A NEW TREATY OR PROTOCOL, BUT THE IDEA THAT A CERTAIN GROUP SHOULD ENJOY TAX FREE STATUS IN THE UNITED STATES WILL NOT BE READILY ACCEPTED. THE TERMS WOULD HAVE TO BE SPELLED OUT AND THE PREFERENCE FOR USSR OVER OTHER FOREIGN CORRESPONDENTS (AND OVER OTHER US RESIDENTS) JUSTIFIED. THE FACT THAT US CORRESPONDENTS WOULD ENJOY EXEMPTION FROM USSR TAX IS NOT PERSUASIVE, SINCE US TAX POLICY IS THAT US CITIZENS LIVING AND WORKING ABROAD MAY BE TAXED ABROAD AND MAY CREDIT THE FOREIGN TAX AGAINST THEIR US TAX. THESE SAME CONCERNS AFFECT THE CASE FOR EXEMPTING TECHNICIANS. THAT

EXEMPTION, TOO, IS ALREADY LONGER IN THE USSR TREATY
THAN IN ANY OTHER US TREATY.

6. IN SUMMARY, WE ARE WILLING TO CONSIDER BROADENING
CERTAIN EXEMPTIONS IN AN AMENDED TREATY, BUT ARE NOT
SANGUINE ABOUT THE PROSPECTS FOR APPROVAL. LEVYING
OF SOVIET TAXES ON US CITIZENS RESIDENT IN USSR IS TO

BE EXPECTED. THAT IS WHAT WE DO AND WHAT OTHER
FOREIGN COUNTRIES DO IN COMPARABLE CIRCUMSTANCES.
US FOREIGN TAX CREDIT IS DESIGNED TO PROTECT AGAINST
DOUBLE TAXATION OF AMERICANS.
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7. WE WILL ADVISE EMBASSY OF RESULTS OF REVIEW OF
EXISTING TREATY FOR RECOMMENDED REVISIONS. DUE TO
OTHER COMMITMENTS DURING REMAINDER OF JUNE, THAT
ASSESSMENT WILL NOT BE READY UNTIL JULY.

8. REGRET THAT REFTTEL B NOT RECEIVED BY TREASURY
IN TIME TO REPLY BEFORE JUN: 12. SHULTZ LETTER TO
PATOLICHEV WAS CAREFULLY NEGOTIATED AND MEANING
CLEARLY UNDERSTOOD BY USSR DELEGATION. A PARALLEL
REPLY FROM PATOLICHEV TO SHULTZ ACKNOWLEDGES AGREEMENT
ON POINTS MADE IN THE LETTER. VANCE

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